

Application of New England Power Company for authorization and approval of: (1) the authority to issue up to \$38.5 million of long-term debt, pursuant to one or more loan agreements or supplemental loan agreements in connection with the refunding of pollution control revenue bonds; and (2) an exemption from the provisions of G.L. c. 164, § 15.

---

APPEARANCES: Geraldine M. Zipser, Esq.

National Grid USA Service Company, Inc.

25 Research Drive

Westborough, MA 01582

FOR: NEW ENGLAND POWER COMPANY

Petitioner

## I. INTRODUCTION AND PROCEDURAL HISTORY

On July 26, 2000, the New England Power Company ("NEP" or "Company"), a subsidiary of National Grid USA Service Company, Inc. ("National Grid") filed an application with the Department of Telecommunications and Energy ("Department") to issue long-term debt pursuant to a loan agreement with the Connecticut Development Authority ("CDA") to back the issuance by CDA of an amount not exceeding \$38.5 million of tax-exempt pollution control revenue refunding bonds ("PCRRBs"). The Company also requests that the Department authorize, as in the public interest, an exemption from the invitation of proposals to purchase requirements of G.L. c. 164, § 15. <sup>(1)</sup>

This petition was docketed as D.T.E. 00-53. Pursuant to notice duly issued, public and evidentiary hearings were held at the Department's offices on August 2, 2000. Thomas Killeen, a senior financial analyst in the treasury services department of National Grid, testified on behalf of NEP. A technical conference was held at the Department's offices

on August 18, 2000. The evidentiary record consists of 21 exhibits and seven responses to record requests.

## II. DESCRIPTION OF THE PROPOSED FINANCING

### A. Issuance of Long-term Debt

In September 1999, the Company entered into a loan agreement with the CDA to support the issuance by CDA of \$38.5 million of PCRRBs (Exh. NEP-1, at 2). These

short-term, tax-exempt and unsecured bonds were issued to refund PCRRBs originally issued by the CDA in 1985 to finance pollution control equipment at the Millstone 3 nuclear generating station (id.). The Company seeks the authority to extend the maturity of the

short-term bonds for an additional 15 years, until October 15, 2015 (id.). NEP proposes a maximum interest rate of eleven percent on new PCRRBs with a variable rate and a maximum interest rate of eight percent on new PCRRBs with a fixed rate (Exh. NEP-2, at 6). Under the terms of the financing, these new long-term bonds would be tax-exempt (Exh. NEP-1, at 2). However, according to the September 1999 loan agreement, the new long-term bonds will lose tax-exempt status if all regulatory approvals relating to the long-term indebtedness are not obtained by September 28, 2000 (id.).

### B. Capital Structure of the Company

As of June 30, 2000, the Company's utility plant in service was \$1,564,640,000, with accumulated depreciation of \$952,688,000, resulting in a net utility plant of \$611,952,000 (Exh. NEP-3, Att. A at 1). As of June 30, 2000, the Company reported a total capitalization of \$403,936,000, consisting of long-term debt of \$371,774,000, common stock of \$72,398,000, other paid-in capital of \$385,444,000, preferred stock of \$1,567,000, a net unrealized gain on securities of \$18,000, and a reduction to capitalization of (\$427,265,000)<sup>(2)</sup> (id.). Therefore, NEP argues that its excess utility plant amounted to \$208,016,000 as of June 30, 2000 (id.).

The preceding amounts incorporate two adjustments proposed by NEP as part of its supplemental testimony: (1) a reduction to its other paid-in capital balance of \$337,148,000, representing the paid-in capital attributable to goodwill (i.e., NEP's share of the acquisition premium associated with the merger between NEP's former parent company, New England Electric System, and National Grid); and (2) a reduction to capitalization of \$427,265,000, an amount attributable to regulatory assets for which NEP argues it has incurred expenses in the past and will recover from ratepayers in the future (Exh. NEP-3, at 3). These proposed adjustments are reflected in the capital structure numbers stated above. In the absence of NEP's proposed adjustments, the Company's capitalization would exceed its net plant by \$556,397,000.

## III. POSITION OF THE COMPANY

#### A. Issuance of Long-term Debt

NEP contends that proceeds from the issuance of these bonds will be used to retire \$38.5 million of short-term PCRRBs issued in 1999 by the CDA on NEP's behalf

(Exhs. NEP-1, at 2; NEP-2, at 3; Tr. at 8). Furthermore, NEP contends that approval of the \$38.5 million is necessary on or before September 28, 2000, to maintain the tax-exempt benefit of the financing (Exh. NEP-1, at 2; Tr. at 24). NEP contends that failure to obtain this long-term, tax-exempt financing would increase the interest costs by as much as \$800,000 annually (Exh. NEP-2, at 7; Exh. DTE-11). In addition, NEP asserts that as tax-exempt bonds, this new long-term debt would offer the Company the opportunity for significantly reduced interest costs when compared to taxable debt, and estimates this reduction in the interest rate to be approximately two percentage points (Exh. NEP-1, at 2).

#### B. Net Plant Test

With respect to the net plant requirement found in G.L. c. 164, § 16, NEP claims that it meets the Department's net plant test, when it includes the two adjustments discussed in

§ II.B., supra (Exh. NEP-3, at 4). NEP argues that, because goodwill is a non-cash item, its removal from the Company's capitalization results in a better indication of the capitalization that is supported by revenue producing assets (Exh. DTE-15). According to the Company, the removal of certain regulatory assets from its capitalization provides a more accurate measurement of items which were financed or capitalized, for which no offset is recognized in net plant (id.). NEP states that, while G.L. c. 164, § 16 requires the outstanding stock and debt of a company be weighed, it does not proscribe how capitalization is to be calculated (id.). Therefore, NEP argues its proposed adjustments do not conflict with the language or intent of G.L. c. 164, § 16 (id.).

#### C. Exemption from G.L. c. 164, § 15

The Company argues that, given the nature of the issuance sought, it is not feasible to have competitive bidding (Exh. DTE-10). The Company contends that notice and competitive bidding for each remarketing would be impossible and preclude this type of financing, since the Company has structured the PCRRB's so that they must be issued frequently to gain interest rate savings benefits (Exhs. NEP-3, at 5; DTE-11).

Further, NEP contends that an exemption from the competitive bidding and publication requirements of G.L. c. 164, § 15, is necessary in order to respond quickly to changes in market conditions and to facilitate the use of a variety of pricing mechanisms

(Exh. NEP-1, at 3). Finally, prior to the selection of Merrill Lynch as the remarketing agent, NEP contends that the Company's corporate finance department compared the performance of three different agents for a ten month period from September 1998 to June 1999 (Exhs.

DTE-2; NEP-3, at 5,6). The Company contends that Merrill Lynch outperformed the competition by an average margin of 12 basis points and, on this analysis alone, was chosen as the remarketing agent (Exhs. DTE-2; NEP-3, at 5,6).

### III. STANDARD OF REVIEW

In order for the Department to approve the issuance of stock, bonds, coupon notes, or other types of long-term indebtedness<sup>(3)</sup> by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.<sup>(4)</sup> Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its § 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al.,

D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of \$1 million in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in the public interest to grant an exemption from the advertising

requirement where there has been a measure of competition in private placement. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127,

at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department has also found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). However, G.L. c. 164, § 15, requires advertising as the general rule, and waiver cannot be automatic but must be justified whenever requested.

#### IV. ANALYSIS & FINDINGS

##### A. Long-term Financing

In order to convert the short-term PCRRBs that were issued as a result of the September 1999 loan agreement between the Company and the CDA to long-term bonds, the Company is required to issue \$38.5 million of long-term debt. This conversion will provide a benefit to ratepayers through reduced borrowing costs for the Company. The reduced borrowing costs result from the tax-exempt status of the new long-term bonds, which will reduce annual interest on the bonds by \$800,000 and reduce the interest rate at which these new long-term bonds will be offered by as much as two percentage points. Therefore, the Department finds that the proposed issuance of \$38.5 million of long-term debt to be issued by October 15, 2000, and bearing an interest rate not to exceed eleven percent on new PCRRBs with a variable rate and a maximum interest rate of eight percent on new PCRRBs with a fixed rate is reasonably necessary to accomplish a legitimate purpose in meeting the Company's obligation in accordance with G.L. c. 164, § 14.

In regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). If a company's financing proposal fails to meet this requirement, G.L. c. 164, § 16, authorizes the Department to prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the capital stock impairment.

As noted above, the Company's capitalization would exceed its net plant by \$556,397,000 in the absence of the two adjustments made by NEP. First, NEP made a reduction of \$337,448,000 to paid-in capital associated with goodwill. The intangibility of goodwill renders it inappropriate for consideration as a component in a utility's capitalization for purposes of G.L. c. 164, § 14. See Boston Gas Company, D.P.U. 17138, at 7-8 (1971). Accordingly, the Department accepts the Company's proposed paid-in capital adjustment.

Second, NEP made a reduction of \$427,265,000 to its total capitalization associated with regulatory assets which the Company has previously funded and will recover from ratepayers in the future. A strict reading of G.L. c. 164, § 16 would prohibit recognition of regulatory assets as a group, per se, when determining a company's net plant. However,

G.L. c. 164, provides for a transition charge and the Department allowed the Company the opportunity to recover these regulatory assets through the transition charge by finding that these regulatory assets qualify as transition costs. See G.L. c. 164, § 1G (b). The Department approved Massachusetts Electric Company's transition charge which included its allocated share of NEP's transition costs, including a pre-tax return based on NEP's 1995 year end capital structure. See Massachusetts Electric Company, D.P.U./D.T.E. 96-25, at exh. Meco-11, app 1, §§ 1.1.1(b), 1.1.2. Also, NEP is in the midst of restructuring, divestiture and mergers; a volatile period which affects the Company's balance sheet. For these reasons, the Department finds that an adjustment to the net plant test is warranted. Whether the adjustment is made by reducing capitalization, as NEP has done, or by increasing the Company's asset base, the Department finds that the net result is reasonable in this specific case, given that the regulatory assets removed from the Company's capitalization are those which the Company has previously funded and has been given the opportunity for future recovery of the costs through the transition charge. The record demonstrates that, with these adjustments, NEP's post-financing assets would be greater than its post-financing capitalization. Therefore, the Department finds that the Company's proposed issuance of

long-term debt meets the requirements of the Department's net plant test as provided in G.L. c. 164, § 16.

#### B. Exemption from G.L. c. 164, § 15

Notice and competitive bidding for each remarketing would be impossible and preclude the type of financing sought in this filing (Exh. NEP-3, at 5). Given that the tax-exempt bonds sought carry an interest rate with a flexible interest period and that the bonds are remarketed frequently, it would not be feasible to require competitive bidding. More importantly, requiring competitive bidding could very well jeopardize the flexibility required in these transactions, and ultimately jeopardize the financial benefits seen by the ratepayers in this financing structure.

The Company has demonstrated its examination into the competition in the private market through its ten month performance review of its three remarketing agents, Merrill Lynch, Salomon Smith Barney, and First Chicago (Exhs. NEP-3, at 5,6; DTE-2). The Company's investigation reveals a level of competition in the marketplace, and its decision to choose Merrill Lynch was based on the fact that it outperformed the others during this period (Exhs. NEP-3, at 5,6; DTE-2). Therefore, an exemption from G.L. c. 164, § 15 is appropriate in this case.

## V. ORDER

Accordingly, after due notice, hearing, and consideration, the Department hereby:

VOTES: That the bonds, or other forms of indebtedness, in principal amount not in excess of \$38,500,000, and bearing and interest rate not to exceed eleven percent on new pollution control revenue refunding bonds with a variable rate or a maximum interest rate of eight percent on new pollution control revenue refunding bonds with a fixed rate, are reasonably necessary for the purpose for which such issuance has been authorized; and it is

ORDERED: That the Department hereby approves and authorizes the issuance by New England Power Company of pollution control revenue refunding bonds through the Connecticut Development Authority with a maturity date of no later than October 15, 2015, in the aggregate principal amount of \$38,500,000 at an interest rate not to exceed eleven percent on new pollution control revenue refunding bonds with a variable rate or a maximum interest rate of eight percent on new pollution control revenue refunding bonds with a fixed rate; and it is

FURTHER ORDERED: That the bonds, notes, or debentures approved in this Order shall be used for the purposes as set forth herein; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

---

James Connelly, Chairman

---

W. Robert Keating, Commissioner

---

Paul B. Vasington, Commissioner

---

Eugene J. Sullivan, Jr., Commissioner

---

Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.



Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).

1. The July 26, 2000, filing was an amendment to NEP's original May 25, 2000, application. In addition to the two components requested in the July 26, 2000, filing, the Company's original application sought an extension of the authority to issue \$300 million in long-term debt for the purpose of funding trigger payments granted by the Department in NEP's divestiture, New England Power Company, D.T.E. 97-94 (1998). NEP intends to refile this long-term financing request at a later date.

2. This proposed regulatory asset adjustment total consists of regulatory assets and liabilities as follows: \$374,932,000 of purchased power agreement buyouts; \$148,205,000 of other contract termination charges; (\$103,937,000) of proceeds on the sale of generating units, net of amortization; \$5,245,000 of a loss on reacquired debt; and \$2,820,000 of other regulatory assets (Exh. NEP-3, Att. B at 1).

3. <sup>3</sup> "Long-term" refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

4. <sup>4</sup> The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds or other securities by a gas or electric company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital.